The Evolution of Guidelines

DOJ/FTC Hearings on Competition and Intellectual Property Law in the Knowledge-Based Economy

February 6, 2002

Washington, D.C.

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Key Principles
1988 and 1995 Guidelines

a) for the purpose of antitrust analysis, the Agencies regard intellectual property as being essentially comparable to any other form of property.

b) the Agencies do not presume that intellectual property creates market power in the antitrust context.

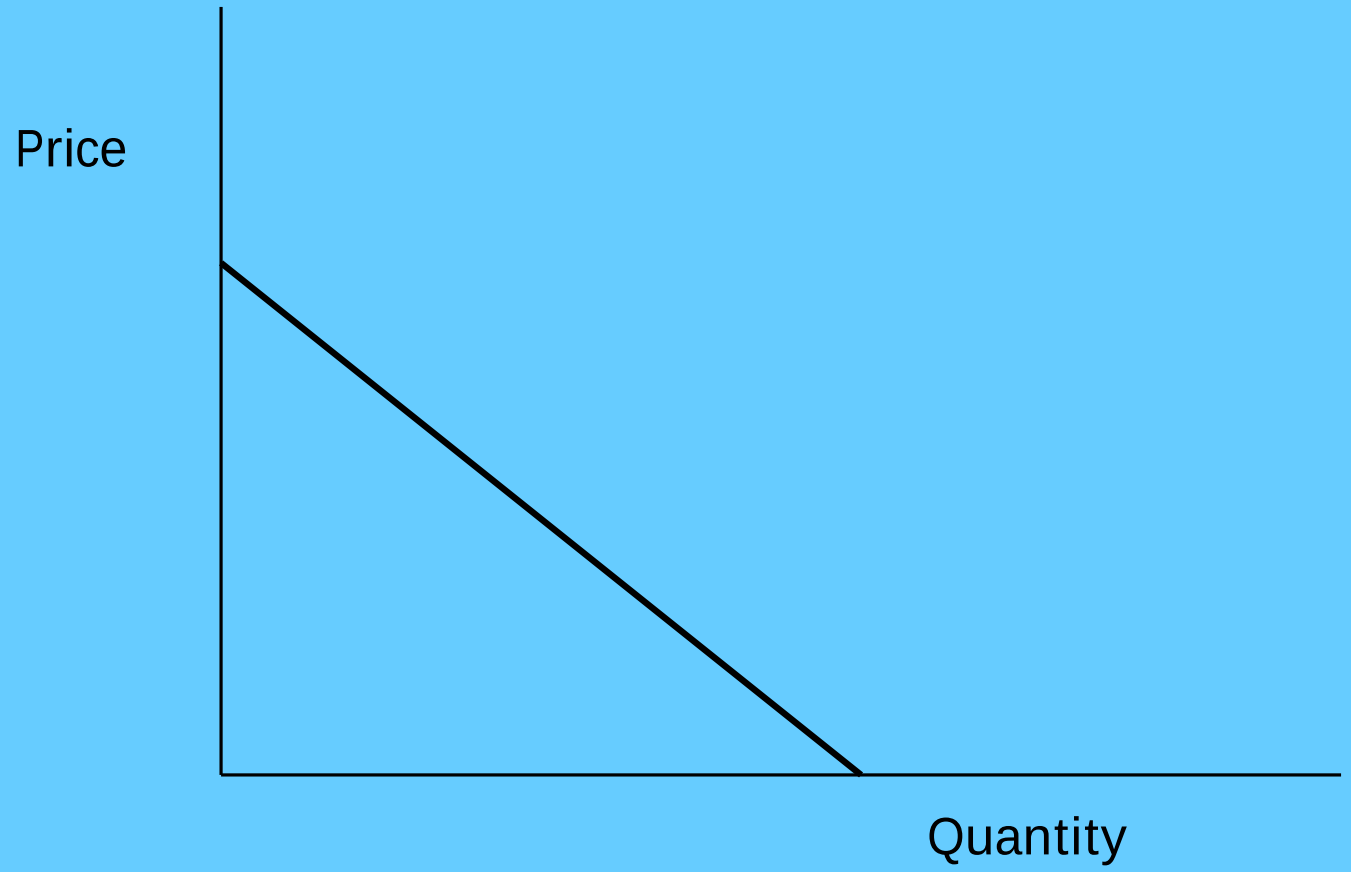
c) the Agencies recognize that intellectual property licensing allows firms to combine complementary factors of production and is generally procompetitive.

Key Principles
1988 Guidelines

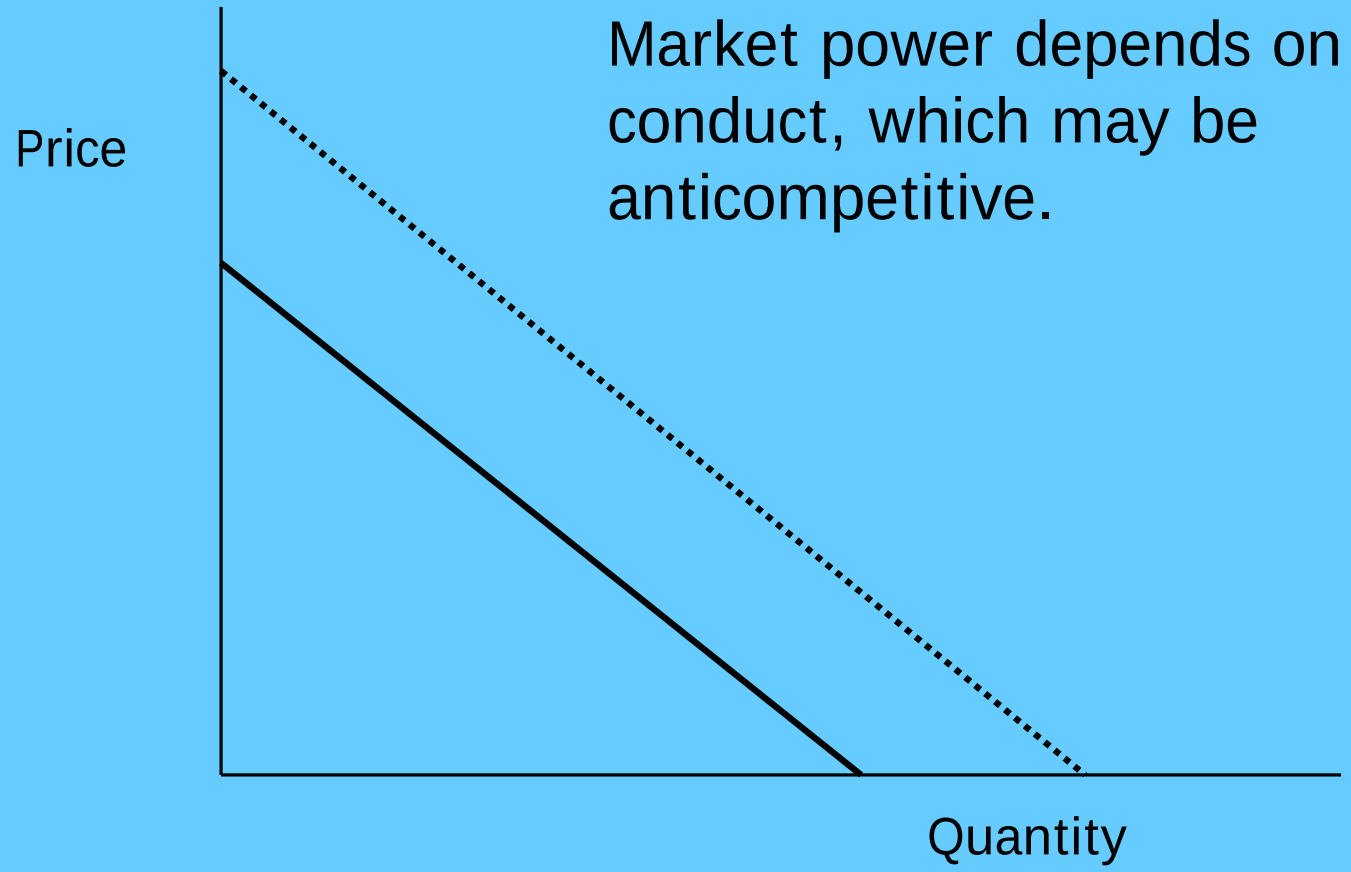
"The owner of intellectual property is entitled to enjoy whatever market power the property itself may confer."

"[T]he Department will not require the owner of technology to create competition in its own technology."

The IP owner is entitled to enjoy whatever market power the property itself may confer

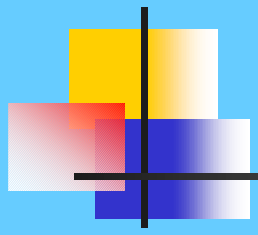


The IP owner is entitled to enjoy whatever market power the property itself may confer: A critique



Market power depends on conduct, which may be anticompetitive.

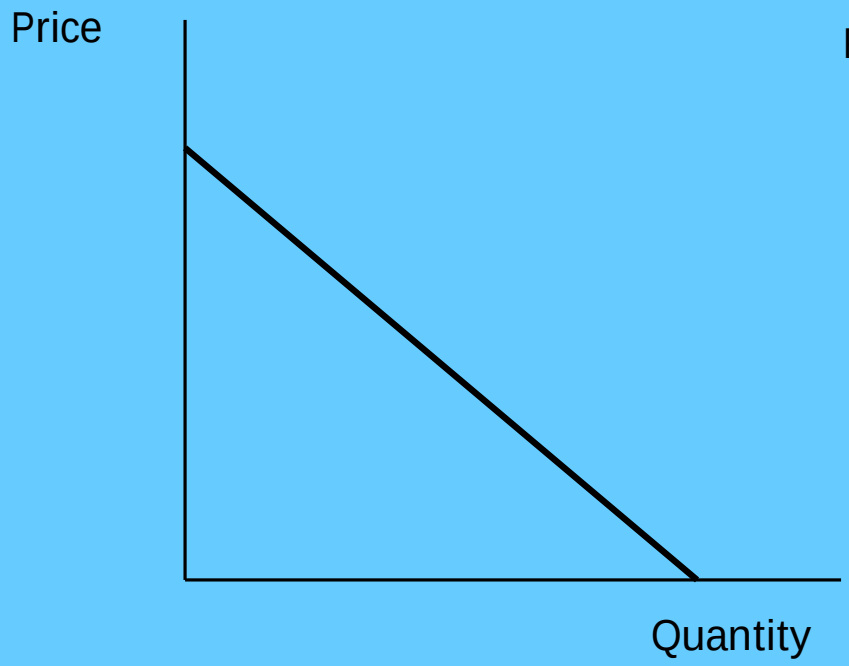
Key Principles
1995 Guidelines



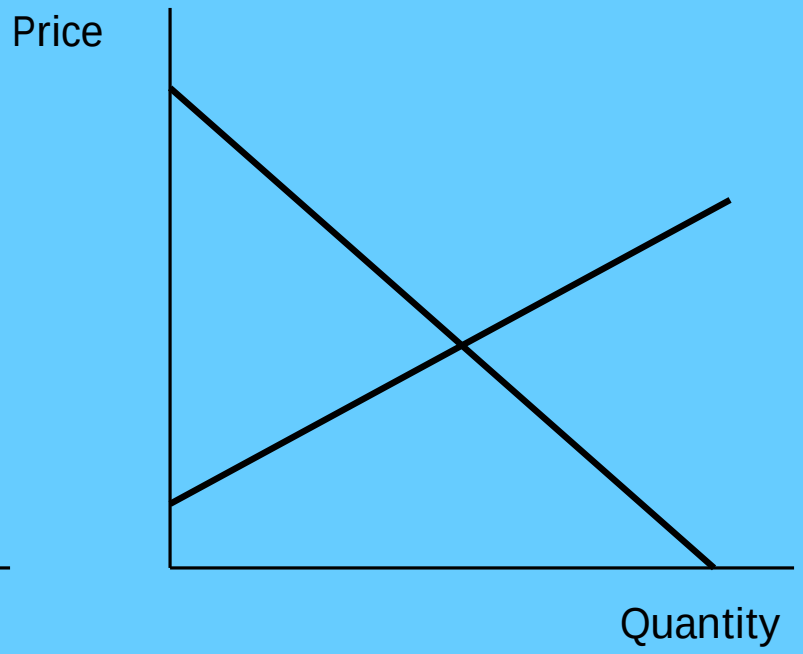
"The Agencies will not require the owner of intellectual property to create competition in its own technology. However, antitrust concerns may arise when a licensing arrangement harms competition among entities that would have been actual or likely potential competitors in a relevant market in the absence of the license (entities in a 'horizontal relationship')."

Harm to competition that would have occurred in the absence of the license

The licensing market



A different market



Harm to competition that would have occurred in the absence of the license

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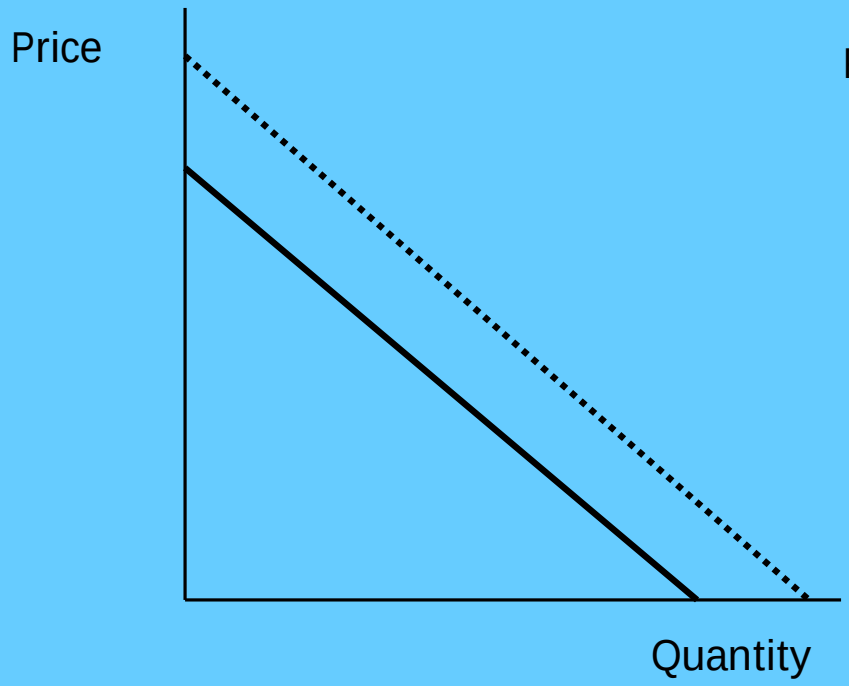
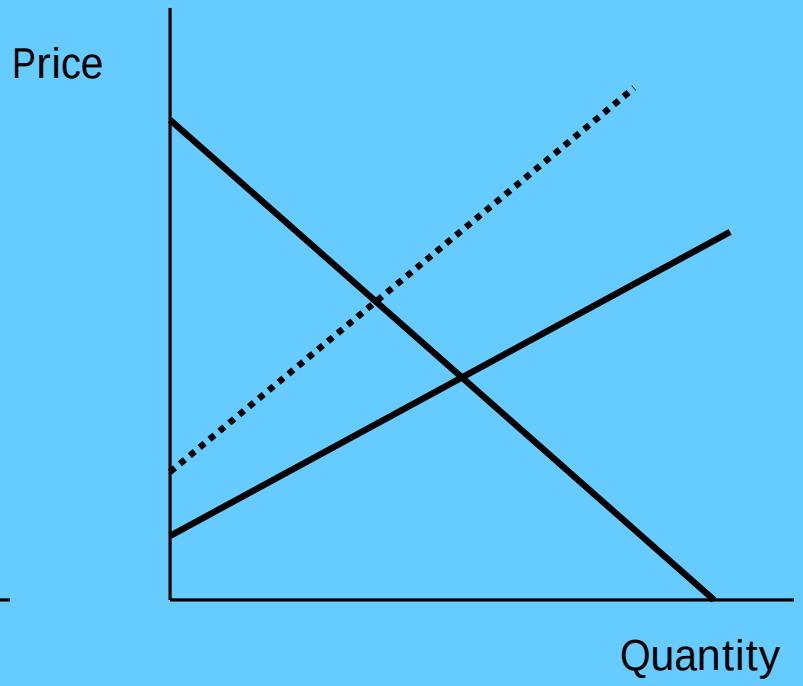


A different market



Key Questions for an Antitrust - Intellectual Property Agenda

- Should antitrust policy be more lenient for intellectual property?
- How to deal with combinations of allegedly blocking patents
- Patent settlements
- Cross-licensing and unilateral refusals to deal
- Standard-setting
- Winner-take-all markets (network effects)

Antitrust Policy For Patent Aggregations – A Noisy Message

- MPEG and DVD letters: OK to aggregate essential (blocking) patents
- FTC v. VISX: pool dissolved
- Ciba-Geigy – Sandoz: concerns raised about aggregation of blocking patents

A Rule of Reason Approach to Evaluating Combinations of "Blocking" Patents

Key elements of the approach

1) Probability that all blocking patents would be found invalid or not infringed
2) Benefits from competition if patents held to be invalid or not infringed
3) Benefits from combining patents

A Rule of Reason Approach to Evaluating Combinations of "Blocking" Patents

(1) X (2) = (Expected) competition that would have occurred in the absence of the licensing arrangement

(3) = Benefits of the licensing arrangement

A Rule of Reason Approach for Evaluating Combinations of Multiple "Blocking" Patents

Define:

N = Number of independent blocking patents

P = Probability that a single blocking patent would be held invalid or not infringed if challenged

C = Reduction in prices from competition, as percent of revenues

E = Efficiencies from combining patents, as percent of revenues

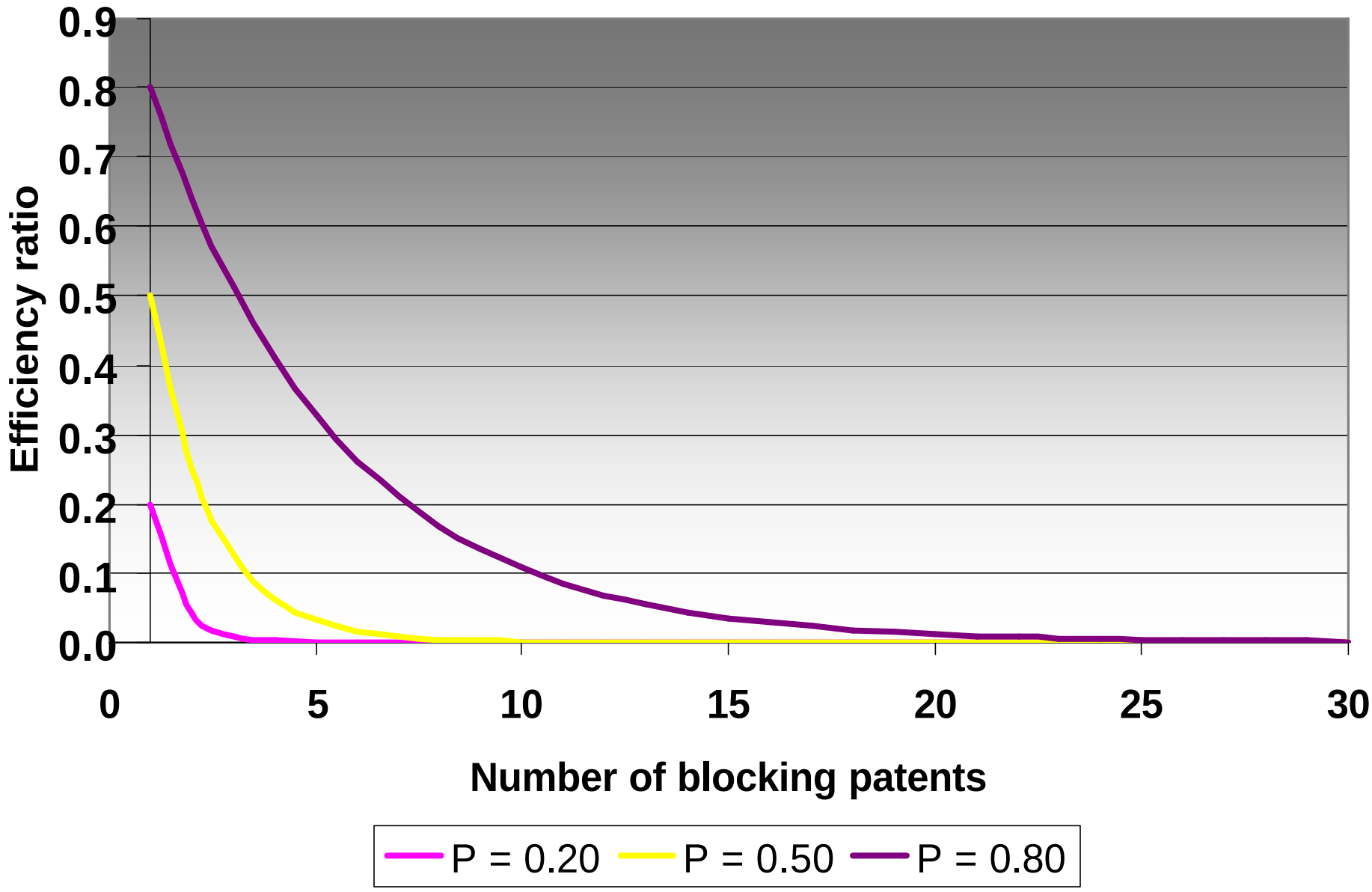
A Rule of Reason Approach for Evaluating Combinations of Multiple "Blocking" Patents

Aggregation passes a rule of reason test if:

$$\frac{E}{C} > P^N$$

E/C = efficiency ratio

Required Efficiency Ratio for Pro-Competitive Patent Aggregation



Applying This Approach to Single Patent Settlements

Challenge a settlement involving a single patent if:

$$\frac{E}{C} < P$$

But this is a difficult potential competition case

Use the rule to guide further inquiry into patent scope, validity

Conclusions Re Combining "Blocking" Patents

- Assertion that patents are blocking should not be sufficient to indemnify a combination from antitrust scrutiny
  - High probability that litigated patents are found invalid or not infringed
- Not necessary for antitrust agencies to conduct a full scale review of patent scope and validity to assess antitrust risk from combining patents
- A probabilistic approach should be sufficient to estimate competition in the absence of the combination

Conclusions Re Combining "Blocking" Patents

- Probability of competition in the absence of the combination declines rapidly with the number of independent, blocking patents
- Efficiencies from combining many blocking patents can be large:
  - Avoid "double-marginalization" with independent licensing of complementary blocking patents (royalty stacking)
  - Avoid delays in launching a new product
    - E.g., MPEG, DVD standards
- Suggests relatively lenient antitrust policy toward combinations with many blocking patents

Private Incentive to Challenge Patents Is Less Than the Expected Social Return

- Users of patented technologies appropriate only some of the benefits of a successful patent challenge, but pay the full cost
  - Benefits shared with other licensees
  - Consumers benefit from competition
- Coordination problem
  - Each user wants someone else to challenge the patent
  - Coordination problem is particularly severe when there are many patents, many patentees
- Implies more resources should be devoted to ascertaining patent scope, validity

A Not-So-Modest Proposal

- Apply agency resources to challenge suspect patent when spillover benefits and coordination problems are particularly large
  - Many users of the patented technologies
  - Multiple blocking patents; multiple patentees
- But -- consider challenging patents involved in allegedly anticompetitive settlements or pooling arrangements (only) when the patents are particularly suspect and settlement-specific efficiencies are small